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QUESTION 1

A firm has daily cash receipts of \$100,000. A bank has offered to reduce the collection time on the firm's deposits by two days for a monthly fee of \$500. If money market rates are expected to average 6 percent during the year, the net annual benefit (loss) from having this service is:

- A. \$3,000
- B. \$12,000
- C. \$6,000
- D. \$(6,000)

Correct Answer: C

Explanation:

Choice "c" is correct. \$6,000 net annual benefit from using a lockbox system.

Daily Cash Receipts	\$100,000/Day
Days Accelerated	$\times \underline{\quad 2 \text{ Days}}$
Increased Cash Receipts	\$200,000
Annual Interest Rate	$\times \underline{\quad 6\%}$
Marginal Revenue	12,000
Monthly Lockbox Fee \$500 \times 12 =	$\underline{\quad (6,000)}$
Net Annual Benefit From Using Lockbox System	$\underline{\underline{\quad \$ 6,000}}$

QUESTION 2

ABC Inc. is expanding its manufacturing plant, which requires an investment of \$4 million in new equipment and plant modifications. ABC's sales are expected to increase by \$3 million per year as a result of the expansion. Cash investment in current assets averages 30 percent of sales; accounts payable and other current liabilities are 10 percent of sales. What is the estimated total investment for this expansion?

- A. \$3.4 million.
- B. \$4.3 million.
- C. \$4.6 million.



D. \$4.9 million.

Correct Answer: C

Explanation:

Rule: The expansion of working capital ($WC = CA - CL$) is treated as an increase in investment. Choice "c" is correct. \$4.6 million estimated total investment for this expansion.

\$4,000,000	Original investment
900,000	[(.30)(3,000,000)] expansion of current assets
<u>(300,000)</u>	[(.10)(3,000,000)] expansion of current liabilities
<u>\$4,600,000</u>	Total investment for expansion

Choices "a", "b", and "d" are incorrect, per the above calculation.

QUESTION 3

The capital budgeting model that is generally considered the best model for long-range decision-making is the:

- A. Payback model.
- B. Accounting rate of return model.
- C. Unadjusted rate of return model.
- D. Discounted cash flow model.

Correct Answer: D

Explanation:

Choice "d" is correct. The discounted cash flow model is the best for long-term decisions. Discounted cash flow methods include NPV, IRR, and profitability index.

Choice "a" is incorrect. Payback and bailout payback do not consider the time value of money or the return after the initial investment is recovered. The difference between the two methods is that bailout payback takes salvage value into account in calculating cash flows.

Choice "b" is incorrect. Accounting rate of return is based on accrual income rather than cash flows. It does not consider the time value of money and is considered inferior to the discounted cash flow methods.

Choice "c" is incorrect. There is no unadjusted rate of return model.

QUESTION 4



Freeman, a single individual, reported the following income in the current year:

Guaranteed payment from services rendered to a partnership \$50,000 Ordinary income from a S corporation \$20,000

What amount of Freeman's income is subject to self-employment tax?

- A. \$0
- B. \$20,000
- C. \$50,000
- D. \$70,000

Correct Answer: C

Explanation: Choice "c" is correct. Guaranteed payments are reasonable compensation paid to a partner for services rendered (or use of capital) without regard to his ratio of income. Earned compensation is subject to self-employment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation are taxable income to the individual or their own individual tax return but is not subject to self-employment tax. The ordinary income reported from a partnership may be subject to self-employment tax (if to a general partner).

QUESTION 5

The monitoring component of internal control excludes:

- A. Assessing information derived from external parties.
- B. Assessing the quality of internal control performance over time.
- C. Improving controls that are not operating effectively.
- D. Eliminating controls that are not operating effectively.

Correct Answer: D

Explanation:

Choice "d" is correct. Monitoring is the process of assessing the quality of internal control performance over time and taking necessary corrective actions. Eliminating a control that is not operating effectively would not be an appropriate corrective action.

Choice "a" is incorrect. Information derived from external parties (such as customer complaints and regulator comments) may be useful in identifying problems with the internal control structure.

Choices "b" and "c" are incorrect. Assessing the quality of internal control performance over time and improving controls that are not operating effectively are part of the monitoring process.



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